DEPARTMENT OF STATE REVENUE

02-20120562.LOF

LETTER OF FINDINGS: 02-20120562
Corporate Income Tax
For the Years 2008 and 2009

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Texas Franchise Tax – Corporate Income Tax.

Authority: Flint v. Stone Tracy Co., 220 U.S. 107, 145 (1911); IC § 6-3-1-3.5(b); IC § 6-8.1-5-1(c); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Aztar Indiana Gaming Corp. v. Indiana Dept. of State Revenue, 806 N.E.2d 381 (Ind. Tax Ct. 2004); Consolidation Coal Co. v. Indiana Dept. of State Revenue, 583 N.E.2d 1199 (Ind. 1991); Tex. Tax Code Ann. § 171.002(a)-(b); Tex. Tax Code Ann. §§ 171.101(a); Tex. Tax Code Ann. § 171.1011(c); Tex. Tax Code Ann. § 171.1011(c)(1)-(2); Tex. Tax Code Ann. §§ 171.1012-.1013.

Taxpayer argues that – for purposes of determining its Indiana income tax liability – it was not required to "add back" the amount of money it paid for Texas Franchise Tax.

II. Interest – Corporate Income Tax.

Authority: IC § 6-8.1-10-1(e).

Taxpayer maintains that the interest charges on the proposed assessment should be abated in part.

STATEMENT OF FACTS

Taxpayer is an out-of-state telephone company which provides both phone and Internet services to residential and business customers. The Department of Revenue ("Department") conducted an audit review of Taxpayer's business records and tax returns. The audit resulted in the assessment of additional income tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted to provide Taxpayer the opportunity to further explain the basis for the protest. Taxpayer chose not to participate in the hearing. This Letter of Findings is written based upon Taxpayer's original protest letter.

I. Texas Franchise Tax – Corporate Income Tax.

DISCUSSION

The Department assessed Taxpayer additional corporate income tax on the ground that Taxpayer failed to add back Texas Franchise Tax. The audit report pointed out that Indiana law "require that all taxes measured by income levied by any subdivision of any state... to be added back to Federal taxable income before NOL or special Federal deductions." The audit report concluded that:

> Upon review of the [T]axpayer's detail schedules supporting their federal return, it was determined that the [T]axpayer had failed to add back personal taxes in arriving at adjusted gross income for reported periods 2008 and 2009. Texas Franchise tax was not added back to the Indiana Corporate Income Tax Return. This tax was added back as an audit adjustment.

Taxpayer disagrees and states that the Texas Franchise Tax is not an income tax because the tax "is based on total revenue, less a 30 [percent] COGS deduction."

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

In calculating "adjusted gross income," Indiana law requires the add back of state income taxes. IC § 6-3-1-3.5(b) states in part.

> When used in this article, the term "adjusted gross income" shall mean the following... [i]n the case of corporations, the same as "taxable income" (as defined in Section 63 of the Internal Revenue Code) adjusted as follows: In the case of corporations, the same as "taxable income" (as defined in Section 63 of the Internal Revenue Code) adjusted as follows:
>
> (1) Subtract income that is exempt from taxation under this article by the Constitution and statutes of the United States.
>
> (2) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 170 of the Internal Revenue Code.
>
> (3) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States. See also 45 IAC 3.1-1-5(2) ("Add back an amount equal to any deduction or

deductions taken pursuant to Internal Revenue Code §62 for income taxes levied by any state of the United States....")

The issue is whether the Texas Franchise Tax is a tax "based on or measured by income...."

Tex. Tax Code Ann. § 171.1011(c)(2008) states that, "[F]or purposes of computing its taxable margin... the total revenue of... a taxable entity treated for federal income purposes as a corporation [is] an amount computed by [adding]: (i) the amount reportable as income on line 1c, Internal Revenue Service Form 1120; (ii) the amounts reportable as income on lines 4 through 10, Internal Revenue Service Form 1120...."

Texas law provides that a taxable entity's revenue – for Franchise Tax purposes – is determined by using numbers from that entity's federal income tax return. Tex. Tax Code Ann. § 171.1011(c)(1)-(2). Once a taxable entity determines its total revenue based on the numbers derived from the federal income tax return, the entity then subtracts certain expenses that it reported on that federal return. Tex. Tax Code Ann. §§ 171.101(a), 171.1011(c). The entity also subtracts certain other statutorily defined deductions to arrive at the entity's "taxable margin." Tex. Tax Code Ann. §§ 171.1012-.1013. After the entity has computed its "taxable margin" it multiples that amount by the applicable tax rate. Tex. Tax Code Ann. § 171.002(a)-(b). The tax rate is.5 percent for retailers and wholesalers and 1 percent for all other industries. Id. The calculation results in the amount of margin tax the entity owes the state of Texas.

The Texas tax is designated as a "margin tax" or "franchise tax" but merely labeling the tax as such does not change the nature of the tax. As explained in Flint v. Stone Tracy Co., 220 U.S. 107, 145 (1911), "[T]he mere declaration contained in a statute that it shall be regarded as a tax of a particular character does not make it such if it is apparent that it cannot be so designated consistently with the meaning and effect of the act." See also Consolidation Coal Co. v. Indiana Dept. of State Revenue, 583 N.E.2d 1199 (Ind. 1991); Aztar Indiana Gaming Corp. v. Indiana Dept. of State Revenue, 806 N.E.2d 381 (Ind. Tax Ct. 2004) (Holding that Riverboat Wagering Tax, although classified as an excise tax measured by the petitioner's adjusted gross receipts received from gaming activities, was subject to the Indiana's add back provision because the tax was "based on or measured by income.")

The Texas tax starts with and is based on the entity's income as reported on the federal income tax. After certain adjustments to that amount, a tax of either.5 or 1 percent is calculated and imposed. It is apparent from the face of the law that the tax "based on or measured by income..." and should be added back pursuant to IC § 6-3-1-3.5.

FINDING

Taxpayer's protest is respectfully denied.

II. Interest – Corporate Income Tax.

DISCUSSION

Taxpayer argues that the Department unreasonably delayed the completion of the audit report following the completion of the audit field work. According to Taxpayer, "At the very least... the interest calculation should be reviewed and stop date adjusted back to August of 2011."

The taxpayer also requested an abatement of interest. Under IC § 6-8.1-10-1(e), interest cannot be abated. ("Except as provided by IC 6-8.1-3-17(c) and IC 6-8.1-5-2, the department may not waive the interest imposed under this section.") Since the interest imposed on the amount owed does not fall within either of the statutory exemptions, the Department is without authority to grant Taxpayer's request.

FINDING

Taxpayer's protest is respectfully denied.

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